Audit's® NEWS ANALYSIS OF SECURITIES OF REAL ESTATE INVESTMENT TRUSTS

Realty Trust Review

March 14, 1980

VOL. XI, No. 5

INVESTMENT STRATEGY AND SELECTION ISSUE

INVESTMENT OUTLOOK: PICKING VEHICLES FOR CONTINUED HIGH INFLATION

It is no news that the prime rate has reached 17-3/4% and that the stock market has given up its gains since the beginning of the year. The question for the realty trust investor is what stance to assume in the face of interest rates that are not going to come down in the short term and a potentially protracted downslide in the market.

Inflation is the keynote concern of all investors--how to protect their capital from erosion in purchasing power, crucial when inflation is galloping along at about a 20% annual clip, with no alleviation in sight. At the moment, we are waiting on the president's anticipated speech about inflation--a balanced budget in 1981 and credit controls seem to be the most likely proposals, but the market seems both to have discounted for these proposals and to have adjudged them as

SPECIAL ANNOUNCEMENT

We are pleased to announce that Nancy G. Boyland has assumed responsibility for Audit's advisory services. Since joining Audit from Standard & Poor's Corp. last year, she has demonstrated the stock judgment and knowledge of a complex field needed to carry these new responsibilities for you. Audit President Kenneth D. Campbell continues to supervise investment advisory policy while handling special research projects, new business planning, and investment banking activities, now being transferred to newly activated Kendale Corp. to maintain Audit's independence.

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PUBLISHED TWICE MONTHLY ON THE SECOND AND FOURTH FRIDAYS SUBSCRIPTIONS $164 ANNUALLY SINGLE COPY $10 (RELATIVE APPEAL $20) RECENT BACK ISSUES $2.00 TO NON-TRIAL SUBSCRIBERS

unlikely to be implemented.

The prognosis for the economy is grim. At a time when productivity is declining, there is no money for investment and development. Long-term financing is unavailable as lenders are unwilling to lock themselves into any kind of interest rates, and short term rates are ruinous, once you factor in the returns that must be achieved both to service debt and to exceed the inflation rate. Savings rates continue at record low levels as the consumer is hit with the double edged sword of soaring costs for basic necessities--food, fuel, and lodging--and the fact that consumer durables seem to be the most prudent investment anyway--a buy-it-now-while-you-still-can philosphy. Even the rates charged by bank credit cards look like a bargain today.

Clearly, the market has been saying for some time that the most attractive investment is in natural resources. The action in the Canadian oil stocks bears this out, as did the runup in the price of gold. However, as the dollar seems finally to be getting stronger as a result of the tight money policies, gold has lost some of its attraction, and the price tumbled to $558 an ounce on Monday, March 10, although it has recovered somewhat. Gold, you see, is strictly a unit of value whose attraction is that no alchemist is continually increasing the world's store of gold the way a government can keep printing money (at least not yet, although there have been some reports that the Soviets now have the capability of transforming lead into gold. If the gold price does keep soaring, this might become an economically feasible operation.)

This (at last!) brings us to real estate. Like the Canadian oils, real estate has the advantage of being a natural resource which is a necessity. The sound reason for real estate's being a long-time inflation hedge is that the values of real estate holdings are expected to increase with the inflation rate. Clearly this cannot be applied across the board, as factors such as location, type and quality of buildings and improvements and management all affect valuation and complicate the question of real estate investment, but the basic tenet holds. And despite the runup in real estate prices, further kickers to value can be expected to obtain, as we will discuss further on.

The REITs remain the most logical vehicle for the investor in real estate. In addition to providing the investor with a liquid instrument and interests in a broader-based portfolio than he could amass for himself, the REITs are generally selling at substantial discounts both from book value and market value--the price the investor would have to pay if he bought the properties directly. Our stance on the REIT shares remains what it has been for the last several months: the property trusts are the recommended investments for long-term appreciation plus income.

These REITs seem well positioned for a continued market downturn, and have weathered the slide until now in good shape relative to the market (refer to the table on page 4). The debacle of 1974, when interest rates were at record levels, will not be repeated. Most equity trust properties are virtually fully rented, unlike 1974, when the market was overbuilt. And the sizable foreign presence in the U.S. realty market will give additional support to values. The U.S. remains attractive to foreign investors as U.S. property prices are cheap relative to those abooard, and this has been enhanced by the depreciation of the dollar. Moreover, unlike domestic investors, foreigners do not have to pay capital gains taxes on sales of either property or stocks. In return for these advantages, foreigners generally are willing to accept lower cash-on-cash returns on real estate investments.

The other factor which can be expected to enhance real estate values beyond that resulting from inflation is the current credit market. At the moment, there is no construction money available, causing development plans to be shelved. As demand for rentals continues unabated,

the moratorium on current construction can only be expected to heighten demand at some further point, leading to further appreciation of real estate values.

The only caveat is that the shares of the equity trusts will not be impervious to a protracted market downturn, as indeed they have not been thus far. Reasons for this include some remaining investor wariness dating back to 1974 (misplaced, as we said earlier), the high interest rates which reduce the present value of dividend streams, causes liquidations in margin accounts, and makes alternative investments, especially money market vehicles, more attractive. The problem with these, of course, is that while the high rates are appealing, the interest is taxed as ordinary income, while the REIT investor can be expected to realize capital gains over time.

The remaining problem is one of timing. Dollar cost averaging would be a solution for some; others wary of a continuing downslide can probably afford to wait a bit on new commitments, at least until the dust settles after the president announces his plans for dealing with inflation. Regardless, many of the equity trusts remain attractively priced for longer term (at least one year, for capital gains treatment) commitments. We move on to a discussion of specific situations and various strategies which can be adopted.

MARKET ACTION: PROPERTY TRUSTS LESS HARD HIT THAN MARKET, SPEC ISSUES GIVE UP GAINS

As the table on page 4 indicates, the shares of the major equity trusts, while sharing in the recent market decline, are off less than the market as a whole. The group price is now 8.3% below the high price of mid February, over a period in which the Dow Jones Industrial Index has declined 9.4% and the S&P 500 Index has declined 10.1%. Moreover, while the Dow and the S&P 500 have given up virtually all their gains since the beginning of the year (the Dow off 2.4% from January 1 prices and the S&P 500 Index up only 0.7%), the prices of the equity trusts remain 5.0% above the level of the beginning of the year. The final indication that the equity trust prices are not tracking the market is that share prices remain 37.0% above prices at the beginning of 1979, while the Dow is essentially flat and the S&P 500 up only 8.9%.

The shares of the other groups tell a different story. Non-qualified trust shares have proved to be more volatile than the market. Recent prices have tumbled precipitously; these shares are largely speculative in nature, and prices reflect hopes for buyouts in many cases. Now that sources of money have just about dried up, these shares hold little immediate attraction, except for a few very special situations. However, indicating the underlying value of assets, share prices remain a very strong 55.1% above the January 1, 1979, level.

Finally, the mortgage trusts, while not as dramatic performers, have a dismal record as compared to the market. Share prices are down 10.9% from the beginning of the year, and 12.2% from the beginning of 1979, the only group not to have exceeded market performance over that period. Yields on these issues average 14.5%, which tells the whole story. These are perceived as purely income vehicles, with a price adjusted to market yields.

These price movements bear out our advice of the last several months, and we continue to abide by those general principles, as we do not anticipate a major change in market conditions in the near term. The property trusts have proved themselves strong even under current market conditions, while at the same time, dips in the share prices of some issues make new commitments appealing. Criteria to use in selecting shares of the equity trusts include:

Portfolios with a large portion of their assets in shopping centers and office buildings, which provide greater

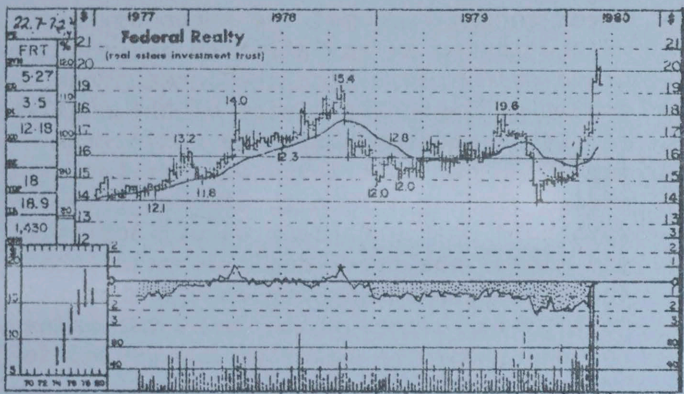
MARKET ACTION IN REALTY TRUST STOCKS

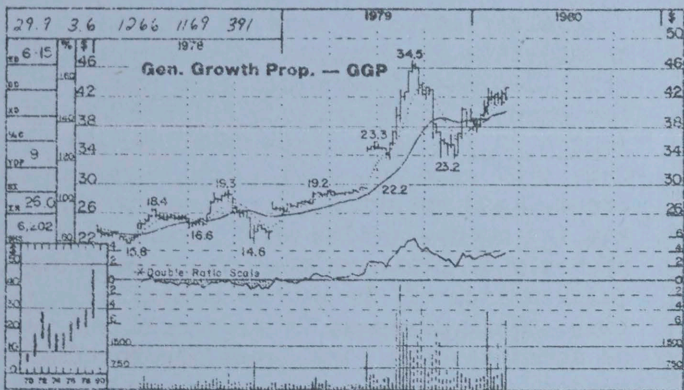
Trust	current price	Mid-Feb. high	%pr.chng. cur/Feb.	price @ 1/1/80	%pr.chng. cur/1/80	price @ 1/1/79	%pr.chng. cur/1/79
Major equity REITs:							
American Equity..	$11.75	$11.75	0.0%	$11.25	+ 4.4%	$ 8.00	+46.9%
ConCap Rlty.......	28.00	29.00	- 3.4	29.00	- 3.4	28.00	0.0
Denver REIA.......	25.00	31.50	-20.6	21.75	+14.9	10.50	+138.1
Federal Rlty......	16.88	21.00	-19.6	15.00	+12.5	14.88	+13.4
First Union.......	16.13	18.13	-11.0	15.38	+ 4.9	10.75	+50.0
Florida Gulf......	16.25	17.25	- 5.8	15.25	+ 6.6	11.75	+38.3
Gen. Growth Prop..	38.13	43.25	-11.8	38.25	- 0.3	26.38	+44.5
Gould Inv.........	13.50	14.38	- 6.1	14.00	- 3.6	8.63	+56.4
GREIT Realty......	10.13	10.63	- 2.4	9.25	+ 9.5	7.13	+42.1
Hubbard REI.......	15.25	17.50	-12.9	16.13	- 5.5	16.13	- 5.5
New Plan Realty...	9.00	9.50	- 5.3	9.13	- 1.4	9.25	- 2.7
Penn REIT.........	19.88	23.88	-16.8	23.63	-15.9	16.25	+22.3
REIT of America...	22.75	23.50	- 3.2	21.25	+ 7.1	15.63	+45.6
San Fran. RE......	22.88	25.38	- 9.9	23.50	- 2.6	18.50	+23.7
Virginia REIT.....	15.50	15.75	- 1.6	11.00	+40.9	11.75	+31.9
Washington RIT....	31.00	31,88	- 2.7	27.88	+11.2	21.00	+47.6
Average			- 8.3		+ 5.0		+37.0
Non-qualified trusts (NYSE or ASE-listed, independent management):							
Bay Financial.....	5.75	6.75	-14.8	6.63	-13.3	4.00	+43.8
Diversified Mtg...	3.50	5.00	-30.0	4.63	-24.4	3.63	- 3.6
Franklin Realty...	19.25	21.50	-10.5	11.75	+63.8	5.00	+285.0
Growth Realty.....	4.75	6.38	-25.5	5.63	-15.6	4.00	+18.8
Institutional Inv.	1.63	1.88	-13.3	1.38	+18.1	2.00	-18.5
Kenilworth Rlty...	32.25	30.25	+ 6.6	28.88	+11.7	11.25	+186.7
Midland Mtg.......	2.88	3.88	-25.8	3.88	-25.8	1.75	+64.6
Mission Inv.......	5.25	6.38	-17.6	6.00	-12.5	4.63	+13.4
Republic Mtg......	2.00	2.75	-27.3	1.75	+14.3	1.38	+44.9
Saul (B.F.) REIT..	5.88	8.38	-29.9	7.25	-18.9	6.38	- 7.8
South Atlantic....	3.25	4.13	-21.2	3.38	- 3.8	3.00	+ 8.3
UMET Trust........	2.50	3.25	-23.1	2.63	- 4.9	1.88	+33.0
U.S. Realty.......	7.25	9.63	-24.7	8.88	-18.4	4.88	+48.6
Average			-19.8		- 2.3		+55.1
Dow Jones I. I.	818.94	903.84	- 9.4	838.74	- 2.4	805.01	+ 1.7
S&P 500 Index....	106.51	118.44	-10.1	105.76	+ 0.7	97.80	+ 8.9

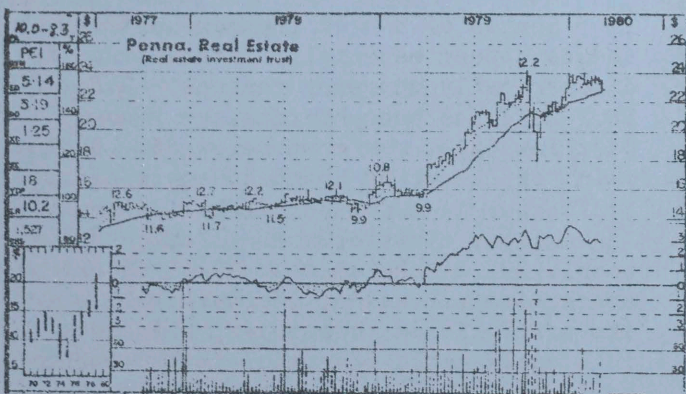
5 largest (market value) mortgage trusts:

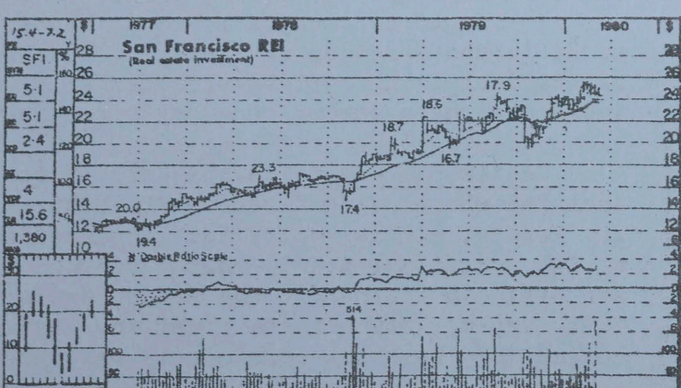
Trust	current price	Current yield*	price @ 1/1/80	%pr.chng. cur/1/80	price @ 1/1/79	%pr.chng. cur/1/79
Equitable M&R.....	13.38	14.9%	14.75	- 9.3	16.75	-20.1
Lomas&Nettleton...	14.25	18.2	19.25	-26.0	15.38	- 7.3
MassMutual M&R....	10.88	13.6	11.75	- 7.4	12.50	-13.0
MONY Mtg. Inv.....	7.38	13.8	7.63	- 3.3	7.63	- 3.3
Northwestern Mut..	8.25	12.1	9.00	- 8.3	10.00	-17.5
Average		14.5		-10.9		-12.2

*February high price omitted as not meaningful.









inflation protection and are more immune to tight money than apartment buildings or development projects.

Locations in strong markets. Both Sunbelt areas and major cities on both coasts remain strong real estate markets, and this is where you'll find the largest concentration of foreign money.

Leveraging with fixed rate debt. Clearly, any trust with sizable short term debt is in for rough times, but this is not a problem for most of the equity trusts.

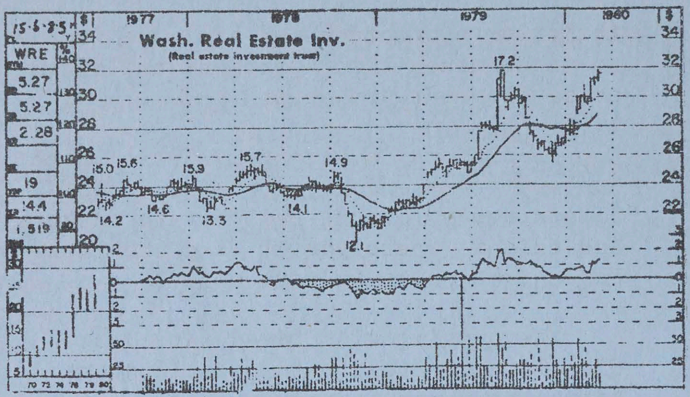
High yields. Many of the equity trusts have yields which are attractive even in the current market, and in some cases, a portion of income is a tax-free return of capital.

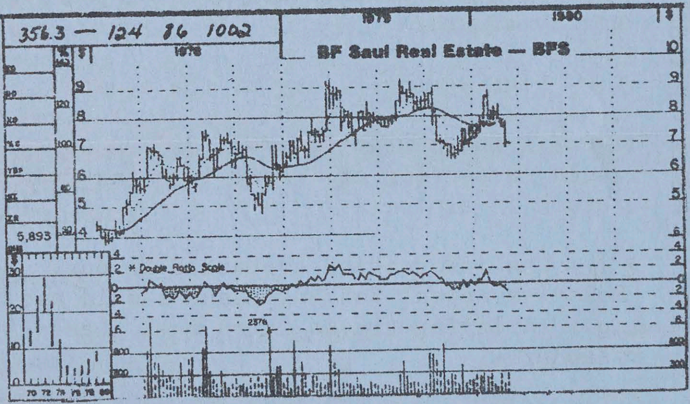
The information contained in our Relative Appeal Ranking issue should aid in identifying trusts which meet these standards.

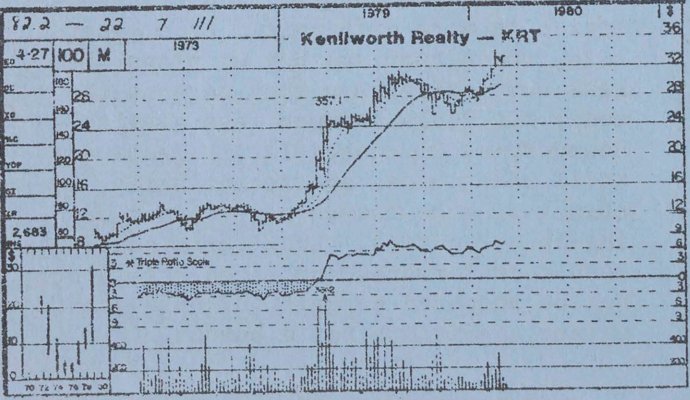
As for the nonqualified trusts, selection is more difficult. As a general rule, those that are buyout plays are less attractive than they were as the money for deals is much less available. However, as discussed later, deals are still being made, and recent price declines in some issues have opened buying opportunities. Look for sizable tax loss carryforwards and fixed rate debt, but be prepared to wait out unfavorable market conditions for a buyout.

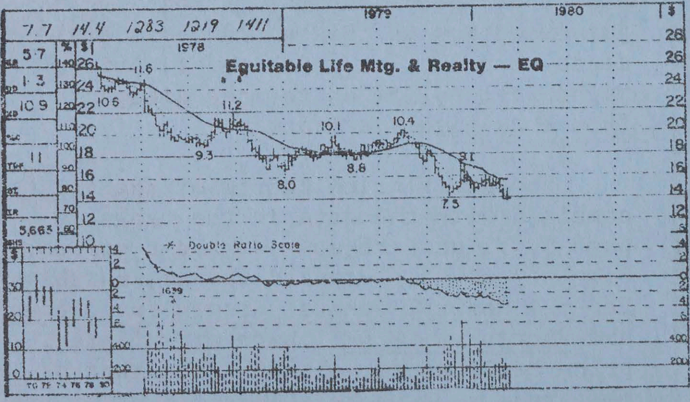
We continue to advise against purchases of mortgage trust shares; the major exception to this would be if dividends were cut, at which point, prices might fall so low as to make discounts from book highly attractive.

The stock price charts of the trusts, combined with the data in the table on page 4, illustrate some of these points. Some of our No. 1-ranked issues, notably Federal Realty, General Growth Properties and Pennsylvania REIT have experienced price declines far sharper than that of the group as a whole. This can be attri-









buted to two factors: the attractiveness of the issues as an inflation hedge which drove prices up, which then occasioned profit taking. The timing of the newsletter was a problem here; the three week gap since our last issue did not let us advise similar action for those of you with holdings in these trusts. But if you missed the tops, don't despair; these trusts remain attractive commitments for just those reasons which drove the price up, and should be held for a recovery in price to earlier levels.

Alternatively, some of the equity trusts have experienced only very mild price declines from their 1980 highs, for example <u>San Francisco REI</u> and <u>Washington REIT</u>. The prices of shares of this type seem to be in a long-term uptrend, less volatile than those of the earlier group. While as a result they probably do not have the potential for the quick upkick of the stocks mentioned earlier, their downside is protected and may be attractive to some investors for that reason.

Shares of two of the nonqualified trusts appear especially interesting, for diametrically opposing reasons. <u>B.F. Saul REIT</u> has been hitting new lows in past few days, now down below $6. Book value of the trust has been appraised at $13/share; in addition, it has $8/share in tax loss carryforwards. Insiders own nearly 20% of the shares. Saul is an attractive situation; virtually all of its portfolio is properties, and there is sizable condo potential in apartment holdings. The exposure here is its $29 million bank debt at 125% of prime; even so, it managed to cut its loss per share to 8¢ in the December quarter. Over half of its debt is in mortgages. The stock appears to have strong recovery potential.

<u>Kenilworth Realty</u> is the only trust included whose price is above its February levels. It is a play for liquidation of its portfolio, nearly half of which are office buildings in the strong New York City market. If the trust were to be acquired by a tax loss entity which could

shelter the proceeds of a liquidation, the appreciation potential is enormous. The recent acquisition of a 12% position by American Financial Corp. (which also has positions in Compass and North American Mortgage) seems to point in this direction. The trust has no rate exposure.

We are using the stock price chart of Equitable Life Mortgage (admittedly the worst performer of the group) as a proxy for the mortgage trust shares. No change in the long term downtrend is anticipated.

REITS IN THE NEWS: ATTEMPTED TAKEOVERS, LIQUIDATIONS, NEW POSITIONS CONTINUE

Metroplex Realty has announced that it has agreed in principle to be acquired by Alburquerque-based Bellamah Corp. and Affiliated Mortgage & Development Corp. for \$12.5 million, or approximately \$1.03/share. The agreement is subject to shareholder approval; the sale price is an attractive premium over the 50¢/share at which the trust had been trading prior to the announcement.

But on the other hand, Nationwide REIT's plans to merge with Buckeye S&L have fallen through for the second time. About a year ago, Buckeye withdrew from a merger agreement with Nationwide because its share price had fallen so low it would have been forced to issue more of its common in exchange for Nationwide than it wanted. Nationwide then sought and received a merger offer from a former suitor, Old Stone Corp. Then last June, Buckeye approached Nationwide with an offer of cash and 9-7/8% convertible preferred Buckeye stock, with a total value of \$19 million. The merger was to have been completed by March 31, but delays in receiving regulatory clearance will prevent this. Thus Nationwide, which believes that the Buckeye offer is not attractive under current market conditions, will exercise its option to withdraw from the agreement on April 1, when the merger has not been completed. But Nationwide is amenable to receiving a new offer from Buckeye.

We have been tracking Sidney M. Baer's steadily increasing interest in Fidelco Growth Investors for some time now, in the expectation that he would try to take another run at assuming control of the trust. You will remember that in January, 1979, Baer filed a 13-D disclosing ownership of some 15% of the Fidelco shares, and stated that he intended to nominate six trustees to oppose the incumbent slate. The slate, including Baer, was nominated from the floor at the July, 1979, annual meeting, but was not elected. Baer and six other holders now own 23.2% of the trust shares, and have announced that they intend to nominate trustees to oppose the existing board. The annual meeting is in April, but the group has said it may call a special meeting before that.

Leland Speed, the president of Eastover Corp., which owns about 26% of the shares of ICM Realty has been elected to the newly created post of chairman of ICM. At the same time, two Eastover trustees, Brent Baird and H.C. Bailey, Jr., were named trustees of ICM. The No. 1-ranked ICM shares remain attractive long-term recovery commitments on the trust's leveraged interest in off the balance sheet real estate holdings.

Actions in trust with large block holdings also include the election of Ralph Strangis and Dean Smith to the board of Central Mortgage; they are members of the Peregrine group, owners of 24.9% of the trust's shares. The David Wolf/Robert Blatt group has increased its interest in Flatley Realty to 10.7%, and Transamerica Mortgage Advisers, advisers to Mortgage Trust of America has raised its interest in the trust to 5.3%. Two entrants to the realty trust arena include Geneve Corp., a diversified company which engages in calatog services, metal fabrication and insurance, which owns 14.6% of Independence Mortgage, and Frank R. and Joanne Warren, who develop and manage real

estate thorugh Warren Properties and acquired 6.1% of the shares of No. 1-ranked Moraga Corp They don't have specific plans to acquire control of the company, but may at some point seek the acquisition of some or all of the Moraga properties.

Icahn & Co. and other companies controlled by Carl Icahn, owner of 38.5% of Bayswater Realty, have acquired nearly 10% of Hammermill Paper Co., and are considering seeking the sale of Hammermill assets, or a merger or acquisition by a third party. Bayswater owns 1.1% of the Hammermill shares (purchased for $1.8 million, or about $22/share), and has said it may consider joining an effort by Icahn & Co. to gain representation on the Hammermill Board.

In the area of finances, GREIT Realty, as it had earlier indicated, has reached a new agreement for the sale of its Northside Shoppin Center in Miami to an overseas purchase, an earlier conditional agreement with other purchasers having been terminated. The agreement calls for a sale price of $9 million, comprising $5.3 million in an existing first mortgage, $1.5 million in cash, and a $2.2 million ten-year secured note. Settlement is expected by April 30, 1980, and will allow GREIT to reverse approximately $1.55 million ($1.55/share) of the $2.2 million loss reserve established for the sale in its October, 1979, quarter.

Riviere Realty has completed the sale of office buildings in Maryland for $2.3 million, resulting in a $1.25/share gain. Proceeds were used to retire its remaining floating rate debt of $1.0 million, accruing at 5% over prime.

Parkway Co. has settled the shareholder class action suit pending since 1975 for $225,000, which had been charged against earnings in the September, 1979, quarter. Parkway said it agreed to the settlement in view of the continuing expense of litigation.

Security Capital has agreed to acquire all the outstanding stock of Houston-based Benjamin Franklin Savings Association from Mischer Corporation for about $20 million in cash. Subject to the approval of the boards of Security and Mischer, the transaction is expected to be completed in late 1980 or early 1981.

Wincorp Industries is joining the Santa Anita Realty bandwagon; the company, which engages in harness racing and real estate development, had said it is considering converting its real estate assets into a REIT. Racing operations would be transferred to a new corporation, and the shares of the two entities would be paired. Wincorp is applying for tax ruling on the reorganization. On the topic of Santa Anita, the trust has declared its first quarterly dividend of 65¢/share, which it said is based on a conservative projection of income for 1980. Santa Anita's predecessor had paid 25¢/share quarterly in 1979.

But in exchange for Wincorp, it looks as if we'll have to give up another REIT, at least for the time being. Remember how, last year, Presidential Realty sought and received shareholder approval to qualify as a REIT as it had used up its tax loss carryforwards and wanted to shelter its income from federal income taxes? To this end, the company sold its property management and property appraisal operations to a company formed by three officer/directors of Presidential. In its annual report for its fiscal year ended in October, 1979, the company reiterated that it intended to qualify as a REIT beginning Jsnuary 1, 1980. To this end, we dropped Presidential from our Housing & Realty Investor service and included it in Realty Trust Review. We have since been informed that although Presidential can qualify as a REIT in 1980, it may not decide to do so--the final decision has not yet been made. Our guess is that the company is waiting to see if it does indeed have earnings which need to be sheltered this year. In any event, we are moving Presidential back to HRI for the time being.